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TO RUEHC/SECSTATE WASHDC 6901
INFO RUEHGZ/AMCONSUL GUANGZHOU 1221
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RUEATRS/DEPT OF TREASURY WASHINGTON DC
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UNCLAS SECTION 01 OF 02 SHANGHAI 000210

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SUBJECT: CIC AND SAFE: SHANGHAI FINANCIAL INDUSTRY VIEWS, LATE MAY 2008

¶1. (SBU) Summary. Visiting Department economic analysts and Congenoff (Econoffs) met May 21-23 with Shanghai financial industry participants and regulators to discuss China's capital market development and sovereign wealth fund issues. Most of the interlocutors agreed that the State Administration of Foreign Exchange (SAFE) is likely to play a more active role in investing China's foreign exchange reserves outside of U.S. Treasury bills, putting it in competition with China Investment Corporation (CIC) as the Chinese Government's primary vehicle for diversifying investment outside of dollar-denominated assets. They were also confident that both the CIC's and SAFE's primary investment criteria would be high returns rather than promotion of other non-financial strategic objectives. End summary.

Introduction

¶2. (SBU) In meetings from May 21-23, Econoffs met with Shanghai financial experts to discuss China's capital market development and sovereign wealth funds. Participants included an American investor and management consultant with over 20 years of experience doing business in China; an American financial consultant with expertise on sovereign wealth fund issues; Deputy Director-General of Statistics and Research Liu Mingzhi and Director-General of the International Department Luo Yang from the PBOC's Shanghai Head Office; a Citibank Managing Director; and former Morgan Stanley Chief Asia Economist Andy Xie.

China Sovereign Wealth Fund Management and Goals

¶3. (SBU) These several interlocutors downplayed or even ruled out the possibility that CIC might use foreign exchange reserves to promote non-financial strategic objectives. The management and financial consultants suggested that highly professional fund managers at CIC would base investment decisions on returns. Xie, however, suggested that bureaucratic incompetence and corruption would handicap CIC's ability to realize such returns. The management consultant noted that this does not rule out possible CIC investments in sensitive areas such as Iran or Venezuela. Nearly all also cited China's inadequate social safety net, particularly with respect to pension obligations,

and the declining value of foreign exchange reserves, primarily in dollar-denominated assets, as the main reason for the creation of the CIC.

¶4. (SBU) The financial consultant expects CIC will be a passive investor, confining itself to purchasing indexes and stakes below 10 percent of issued shares This will allow CIC to quickly invest its $200 billion into a diversified and balanced portfolio. He expects CIC will use Norway's Government Pension Fund as a model. This, as well as public comments made by CIC's Managing Director, Gao Xiqing, suggest a commitment to transparency, which he notes will become more apparent as CIC makes more investments. Xie, however, believes the CIC invests passively because its investment managers do not have the experience or expertise to make larger equity investments outside of financial institutions. He co